A Report on an Investigation of Insurance Broker Contingency Fees at Selected Companies and Brokerages

January 30, 2006

Washington State
Office of the
Insurance Commissioner

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www.insurance.wa.gov

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Background

In mid October 2004, Eliot Spitzer, the attorney general for the State of New York, stunned America's insurance industry, announcing a lawsuit against the nation's largest insurance brokerage, as well as on-going investigations directed at several of the nation's largest insurers.

The lawsuit, naming Marsh & McLennan Companies Inc., alleged improper payments, bid rigging and anti-competitive activities.

In the weeks that followed, reverberations from the announcement and continuing developments were felt across the nation, including here in Washington where Marsh had licensed brokers authorized to conduct business.

Washington Insurance Commissioner Mike Kreidler immediately responded to Spitzer's revelations by issuing a strongly worded Technical Assistance Advisory, reminding Washington's licensed brokers and insurers of their duties and responsibilities to insured parties.

As a result of Washington's disclosure requirements, Kreidler and the Office of the Insurance Commissioner were far better positioned to protect Washington consumers than most of his fellow regulators across the nation.

Spitzer's lawsuit and related investigations were based on his office's two-year evaluation of extensive information gathered during a comprehensive, six-year probe of New York-based brokerages and insurers by that state's department of insurance.

Kreidler, conferring with his fellow regulators through the National Association of Insurance Commissioners (NAIC), agreed that the prudent course would be for each state to conduct a survey to determine if there were similar compensation issues or improper behavior occurring elsewhere in the nation as well. It was recognized that the scope of the individual state investigations wouldn't approach the level of detail and thoroughness that the New York Department of Insurance achieved during the course of its six-year inquiry and Spitzer's subsequent scrutiny over a two-year period.

This report summarizes what the Office of the Insurance Commissioner learned about broker solicitation activities during its investigation of brokerage firms and insurance companies here in Washington.

(Note: Spitzer's lawsuit against Marsh was resolved in a settlement that was announced in January 2005. Under terms of the national agreement, Marsh offered $850 million in restitution to clients nationwide. In addition, Marsh did not dispute the lawsuit's allegations. Earlier, the company discontinued the practice of receiving contingent compensation from insurance carriers. Spitzer's other probes involving other leading brokerages and insurers continue.

In a related development, Kreidler headed a small working group of state regulators through the NAIC that negotiated a multi-state settlement with Marsh that enabled individual states to enforce terms and conditions of the restitution and regulatory agreement reached in New York.)

Executive summary

The Insurance Commissioner's solicitation activities investigation targeted the top 11 brokerages in the state and the seven largest Washington-based insurance companies. Primary tools for the investigation included a 10-question survey developed in coordination with other regulators through the NAIC, and a request for certain documentation.

The investigation was launched in late 2004, and concluded in October, 2005.

Based on the responses received and documents examined during this limited inquiry, the Office of the Insurance Commissioner did not find that brokerages and leading insurers in Washington were engaged in the conduct that was alleged in New York. However, the Insurance Commissioner's investigators did find instances where compensation was not disclosed as required by state law. Follow-up inquiries have been initiated in those cases and potential disciplinary action will be taken where appropriate.

As a result of the findings, the Insurance Commissioner has developed four recommendations to ensure that Washington's insurance-consuming public is protected from inappropriate transactions.

The investigation

The investigation of brokerage firms and insurance companies in Washington was intended to determine if the use of contingent commission arrangements by brokers and companies resulted in prohibited or improper practices. Washington law requires the disclosure of such payments, or the potential for such payments, to help prevent improper practices, since insureds could take this information into account in deciding whether or not to purchase the particular coverage.

In order to ensure consistency, state regulators, through the NAIC, agreed to a common methodology and process, including a jointly developed template of questions (See Appendix A) and request for documentation (Appendix B).

The brokers investigated

Acordia Northwest, Inc.

Aon Risk Services of Washington

Brown & Brown of Washington

Cochrane and Company

Crump Insurance Services Northwest, Inc.

Griffin Underwriting Services

Kibble & Prentice

Marsh & McLennan

Superior Underwriters, Inc.

Swett & Crawford Corp.

Willis of Seattle

The companies

Although the investigation included a number of Washington-based insurers at the onset, the scope of the investigation was limited to brokerages early on. The investigation assumed that insurance companies would be part of any disclosure problem regarding contingent commissions. After receiving and reviewing documents from the insurers, the investigative team determined that these companies primarily provide products through the independent agent system, and do not provide products very often, if at all, through the brokerage system. Since the investigation was reviewing a problem involving disclosure by brokers or a combination agent/broker, the pursuit of information from the companies was halted, and efforts were focused on the brokers.

Questions

Generally, the questions were aimed at eliciting information related to:

- The name of any parent affiliates or corporate entities
- Descriptions of the compensation arrangements with insurers
- Self-initiated investigatory efforts
- Subpoenas or requests for information
- Civil litigation or regulatory inquiry or action
- Investigations or indictments
- Reinsurance
- Inappropriate solicitation activities and internal controls to prevent these activities

Requested documentation

Documentation requests focused on:

- The relationship between brokerages and companies, and subsidiaries and affiliates
- Documents subpoenaed by any state attorney general (related to contingent commission agreements)
- Compensation arrangements
- Income or revenue
- Compensation structures for account executives, supervisors and other employees
- Incentives to employees
- Client lists
- Documents related to disclosure, training, recordkeeping, revenue analysis, investments, means of payments, loans, premium payments, preferential treatment and marketing materials

Materials received

In the weeks and months that followed the initial request for information, the Office of the Insurance Commissioner received 67 boxes of documents and records.

The collected information was stored in a secure room where it was reviewed and evaluated by a team of examiners. In addition, an investigative team conducted on-site examinations of two of the brokers.

Findings

The following is a summary of the findings by company.

Acordia Northwest

Acordia Northwest is a direct subsidiary of Acordia, Inc., of Chicago, which in turn is a subsidiary of Wells Fargo & Company. Acordia Northwest enters into agency agreements with various insurers for contingent commissions or bonus commissions. These are based on volume or loss ratios or combinations of both.

Parent company Wells Fargo has initiated an independent review of Acordia, Inc. and its subsidiaries related to solicitation activities.

Acordia Northwest has not been subpoenaed in connection with broker compensation arrangements, but some Acordia, Inc. affiliates have been.

The company has internal controls in place to prevent inappropriate solicitation activities.

The agency's review of the information and documentation disclosed no evidence of inappropriate solicitation.

Aon Risk Services, Inc. of Washington

Aon Risk Services, Inc. of Washington is a wholly owned subsidiary of Aon Corporation, a public company with principal offices located in Chicago, Ill.

Aon Corporation entered into a $190 million national agreement with New York officials to pay clients and former clients whose placements resulted in contingent commissions for Aon between 2001 and 2004.

The Office of the Insurance Commissioner is currently involved in negotiations as part of a multi-state agreement which will benefit Washington policyholders who purchased coverage through Aon.

Brown & Brown of Washington, Inc.

Brown & Brown of Washington, Inc., is a subsidiary of Brown & Brown, Inc., a Florida corporation. The company, with offices in Seattle and Tacoma, is ranked by Business Insurance as the nation's eighth-largest insurance broker.

Investigators obtained a listing of policies written by eight insurance companies that paid contingent commissions to Brown & Brown during the past four years. The policies were entered into a spreadsheet, sorted and analyzed.

Investigators also reviewed additional policies that could have been steered to an insurer for contingent commissions, but no evidence of inappropriate conduct was found. Investigators reported there was no evidence of inappropriate solicitation activities found during the review and on-site examinations.

Cochrane & Company

Cochrane & Company is affiliated with the Cochrane Agency of Oregon, Inc., and TEPCO Premium Finance.

Cochrane is a surplus lines broker that represents numerous markets on a brokerage basis and as a general agent for insurers. The company serves as an underwriting arm of the companies they represent. As such, it has no direct contact with any insureds, dealing only with retail agents or brokers. Its underwriters tailor products for the individual clients of its agent by evaluating risk and looking at available markets to write the risk and determine price and coverage.

As a wholesale broker, the company accepts business from producing agents and brokers – usually a difficult-to-place risk. Cochrane, as a general agent of the insurer, does the underwriting and issues the policy, acting as a branch office of the insurer. The only quote would go to a retail agent, and it would be with one of the companies that Cochrane represents. Any competing quotes would be the responsibility of the producing agent for the insured. As such, disclosure of commissions and fees would be the producing agent's responsibility.

Cochrane does not compensate employees on a commission basis.

The agency's review of the information and documentation disclosed no evidence of inappropriate solicitation.

Crump Insurance Services Northwest, Inc.

Crump Insurance Services Northwest, Inc., is a subsidiary of the Crump Group, Inc., of Dallas, Texas. The Crump Group is owned by VOSCO which is owned by Victor O. Schinnerer & Company, Inc., a Delaware corporation which is owned by Marsh & McLennan.

Crump Insurance Services Northwest, Inc., is a wholesale surplus lines broker that deals directly with other agents and brokers. It has no direct interaction with insureds. Retail or producing agents and brokers submit applications to Crump on behalf of insureds. Crump issues quotes to the retail agent. Competing quotes are the responsibility of the producing agent. Crump places the risk with a represented insurer, then underwrites and issues the policy.

Based on this information, it was determined that this broker represents a minimal risk for inappropriate solicitation activities. Additional investigation was deemed unnecessary.

Griffin Underwriting Services

Griffin Underwriting Services is a subsidiary of Cochrane, Griffin & Co. As a wholesale writer, Griffin does not deal directly with any insureds, but rather with the agents of the insureds. As such, it acts like a branch office of the insurer, underwriting and issuing policies. The retail or producing agent submits the application to Griffin, and Griffin issues a quote to the producing agent. The quote will be for the insurer that will write the particular risk. Producing agents, representing the insureds, are responsible for any competing quotes from other general agents or insurers.

Based on this information, it was determined that this broker represents a minimal risk for inappropriate solicitation activities. Additional investigation was deemed unnecessary.

Kibble & Prentice Holding Company

Kibble is a stand-alone company that acquired seven different entities prior to May 31, 2004. The company has three different lines of business in which it serves as agent and/or broker, and has different compensation agreements with insurers for each line of business.

- Property and casualty: The company has contingency fee arrangements with a number of insurers. Approximately 30 percent of property and casualty premiums are placed with insurers with contingent commission agreements.
- Employee Benefits: This division has agreements with a number of insurers.
- Private Client Group: This division provides agent services to individuals in connection with the placement of life insurance. There are no contingent commission arrangements for this line of business.

The agency's review of the information and documentation disclosed no evidence of inappropriate solicitation.

Marsh & McLennan

Marsh USA is the entity that holds insurance producer licenses for Washington and a number of other states. The direct parent is Marsh, Inc., which in turn is a wholly-owned subsidiary of the Marsh & McLennan Companies. Marsh USA formed an entity called Marsh Global and required all offices across the nation to submit the large commercial accounts to New York for marketing. Marsh USA agreed to the national settlement referenced in the background section. Washington insureds were eligible for their portion of the national settlement.

As part of the national settlement, Marsh voluntarily discontinued the practice of receiving contingent compensation from insurance carriers. Washington state subsequently signed a multi-state agreement with Marsh, implementing terms and conditions of the national settlement announced in January.

Superior Underwriters

Superior Underwriters is the trade name for Groninger & Co., the corporate entity. Superior is a wholesale agent and only deals with retail or producing agents. The producing agent submits an application on behalf of an insured. Superior reviews the application, determines which of its represented insurers will write it, and provides a quote. Superior underwrites and issues policies for the insurers it represents. Any competing quotes are the responsibility of the producing agent.

Based on this information, it was determined that this broker represents a minimal risk for inappropriate solicitation activities. Additional investigation was deemed unnecessary.

Swett & Crawford Corp.

Swett & Crawford is a wholly owned subsidiary of Aon Corporation. Swett is a wholesale agency and doesn't deal directly with insureds. The retail or producing agent submits an application. Swett provides a quote based on the insurer that will write the risk. Swett performs the underwriting and issues policies for the companies it represents. Competing bids from other general agents or insurers are the responsibility of the producing agent or broker. Disclosure of contingent commissions or fees to the insured is the responsibility of the producing agent or broker.

Based on this information, it was determined that this broker represents a minimal risk for inappropriate solicitation activities. Additional investigation was deemed unnecessary.

Willis of Seattle, Inc.

Willis of Seattle, Inc., is a wholly owned subsidiary of Willis of Greater New York, Inc., which is a wholly owned subsidiary of Willis of Michigan, Inc., which is in turn a wholly owned subsidiary of Willis North American, an indirect subsidiary of Willis Group Holdings Limited. Willis North American is the parent company for all of the North American operations of Willis Group Holdings Limited, a publicly traded company on the New York Stock Exchange.

Willis of Seattle, Inc., is a full service insurance brokerage firm that has been servicing clients in the Pacific Northwest since the 1940s. They employ approximately 70 professionals with expertise in all areas of property, liability and employee benefits. Their clients are diverse, representing many different industry sectors.

The Office of the Insurance Commissioner is currently involved in negotiations as part of a multi-state agreement which will benefit Washington policyholders who purchased coverage through Willis.

Conclusions

The Insurance Commissioner's investigation of Washington's leading brokerages and insurance companies did not reveal evidence of unlawful solicitation activities or behavior.

However, during the course of the initial investigation, examiners encountered many instances where brokers failed to meet the requirements of state law relating to compensation disclosure. Specifically, insureds were not being informed that the broker could be paid a contingent fee or commission by insurers for placing business with them. The infractions, while minor in nature, nevertheless represented violations of laws intended to protect consumers and allow them the broadest possible knowledge upon which to base purchasing decisions.

As a result of these findings, the Insurance Commissioner's office launched an ancillary round of inquiries, surveying 31 additional Washington brokerages and agencies to determine if disciplinary action was warranted. The examiners sent letters to the firms, requesting information related to compensation disclosure, practices and documentation. Upon receiving those replies, the team identified seven brokerages that were targeted for more extensive review.

Examiners found more than 170 instances in which requirements were not met. Infractions included omitted signatures, late disclosure, no disclosure and missing documentation.

One of the brokerages tallied dozens and dozens of violations. Another firm registered only one violation, and another had no violations at all.

The violations uncovered in the secondary investigation are being individually addressed through the agency's usual regulatory process.

The examining team also reported that, as a result of the investigation and contact with the agency, some brokers immediately began disclosing such compensation agreements.

Recommendations

As a result of information obtained during the course of this investigation, the Insurance Commissioner's office will be pursuing steps to better protect Washington's insurance-consuming public. As previously noted, the agency is pursuing additional inquiries into specific instances where brokers failed to meet disclosure requirements.

So, while no major problems or unlawful solicitation activity or behavior were discovered, the investigation nevertheless highlighted a stark reality: some of Washington's agent/broker community seems confused and uncertain about compensation disclosure issues and requirements. During the course of the agency's investigation, it became clear that the Office of the Insurance Commissioner should bolster its outreach efforts to inform and guide the agent/broker community on the issue of disclosure.

Insurance is an industry built on a basic principle of trust. The Insurance Commissioner is committed to fostering an environment where everyone involved in the industry strives for integrity through good faith, honesty and fairness in all insurance matters.

The Office of the Insurance Commissioner encourages consumers to gather all pertinent information and educate themselves before making insurance purchasing decisions. Pertinent information includes compensation arrangements. Consumers are entitled to know all the facts surrounding insurance transactions, including compensation arrangements.

In order to achieve this goal, the Insurance Commissioner's office will move forward on several fronts to ensure that Washington's insurance consumers are protected with regard to compensation agreements. These include:

- **Technical Assistance Advisory**
  The agency issued a Technical Assistance Advisory (TAA T 04-05) on Oct. 21, 2004, to remind Washington's 87,000 agents and brokers of disclosure requirements and other responsibilities to insureds. The agency will be working with agent/broker groups, associations and other professional organizations to ensure the continued and widest possible distribution of this advisory.

The agency will develop an additional advisory to provide further guidance and instruction to agent/brokers regarding contingency compensation.

- **Licensee emphasis**

  When the staff of the Insurance Commissioner's office performs audits of licensees, it will place added emphasis on reviewing disclosure documents for compliance with requirements.

- **Proposed legislation**

  The Insurance Commissioner has proposed legislation this session to extend current disclosure requirements to brokers in the life and disability lines of insurance. Current disclosure requirements only pertain to brokers in the property and casualty lines. The Insurance Commissioner will seek to have the compensation and broker disclosure requirements apply to all agent/broker combinations.

- **Targeted enforcement**

  While the agency recognizes that this investigation only touched a fractional percentage of the total number of Washington-based agencies and brokerages, it nevertheless revealed a problem believed to be widespread in scope, affecting a significant portion of the industry. Unfortunately, the agency simply doesn't have the resources available to enforce compensation disclosure requirements across the industry in a comprehensive manner. It does, however, have the ability to survey randomly targeted agencies and brokerages as it did in the follow-up investigations noted above. Periodically, the agency will initiate targeted surveys of randomly selected agencies and brokerages. Violations of compensation disclosure requirements will be addressed through the agency's regulatory authority, and disciplinary actions will be publicly disclosed. The agency believes the "sentinel effect" from these disclosures will help foster an atmosphere of compliance.

Appendices

Appendix A

Questions asked

1. Is (name of licensee) a subsidiary or affiliate of any other corporate entity? If so, please provide the name and address of such entity(s).

2. Provide a description of the types of compensation arrangements with insurers entered into by your company, or your employees or producers acting as brokers, from January 1, 1998 to present, including, but not limited to, bonuses, commissions, "contingent commissions," "placement service agreements," "market service agreements," profit sharing arrangements, and or any other form of compensation, whether contracted for or not. For each such arrangement, identify all insurers and explain the nature of the arrangement and what event(s) each component of the compensation was or is based on.

3. What specific steps have you taken and what additional steps do you plan to take to investigate whether your company, or any of your employees or producers, directly or indirectly participated in Inappropriate Solicitation Activities? If your company has hired any outside investigators, auditors, legal counsel or other consultants in connection with such an investigation, please identify the vendor and describe the scope of the assignment.

4. Have you, or any of your employees or producers, received any subpoenas, written requests for information or other inquiries from any governmental entity or litigant seeking information related to broker compensation arrangements within the last two years? Please specify the particulars of all such requests.

5. Is your company, or any of your employees or producers, a party in any civil litigation, or the subject of any other regulatory inquiry or action, where allegations of Inappropriate Solicitation Activities have been involved? If so, please identify the case caption, jurisdiction and status for all such litigation and other regulatory action or inquiry occurring at any time since January 1, 1998.

6. Are you or any of your employees or producers, the subject of an investigation or under any indictment that may allege or be related to issues involving Inappropriate Solicitation Activities?

7. Has your company, any of your employees or producers, conducted or otherwise been involved with Inappropriate Solicitation Activities? If so, please provide details of all such requests.

8. Is your company aware of any transaction(s) in which an insurer was required to purchase reinsurance or any other insurance product through your company as a condition of that insurer being selected to provide insurance coverage or awarded placement of an insurance policy? Please provide details of all such transactions.

9. Does your company have in place internal controls intended to prohibit Inappropriate Solicitation Activities? If not, why? If so, please provide the details of these internal controls.

10. Have you reviewed your internal controls, including conflict of interest policy, to determine whether Inappropriate Solicitation Activities would have been detected? If not, why? If so, please provide the results of your review.

Appendix B

Requested materials and documents

1. As may be applicable, provide all documents showing your relationship to Marsh Global Broking, Inc., and/or Marsh, Inc., and their subsidiaries or affiliates.

2. All documents provided to any state attorney general in response to any subpoena received in connection with the investigation of contingent commission agreements, placement service agreements, market services agreements or other compensation agreements, bid-rigging, tying arrangement or improper steering activity.

3. All documents created during the past ten years concerning compensation arrangements, placement service agreements, market service agreements, contingent commission agreements and any other agreements providing for payment of compensation to [name of broker] between [name of broker] and any insurer.

4. Documents sufficient to show all income or revenue received by [name of broker] in connection with insurance transactions concerning Washington Insureds or Washington risks pursuant to Compensation Arrangements and the sources of that income or revenue.

5. For each [name of broker] branch or regional office, documents sufficient to show income or revenue received by that branch or regional office in connection with insurance transactions concerning Washington insureds or Washington risks pursuant to Compensation Arrangements.

6. All documents concerning the relationship between Compensation Arrangements and [name of broker]'s placement of insurance on behalf of clients including, but not limited to, insurance business on behalf of clients not placed with an insurer because the insurer refused to enter into a Compensation Arrangement acceptable to [name of broker].

7. Documents sufficient to show the compensation structure since January 1, 1998, for [name of broker] account executives or other employees who service client accounts and their supervisors.

8. Documents sufficient to show the compensation structure since January 1, 1998, for all [name of broker] employees responsible for deciding where to place insurance or insurance-equivalent business for particular clients.

9. Documents sufficient to show all incentives provided to [name of broker] employees since January 1, 1998 for placing insurance on behalf of clients with carriers with which [name of broker] has or had Compensation Arrangements.

10. Organizational charts for [name of broker]'s brokerage business since January 1, 1998.

11. A complete list of clients for whom [name of broker] has placed insurance since January 1, 1998.

12. All documents concerning any disclosure of Compensation Arrangements by [name of broker] to its clients.

13. All requests for information concerning Compensation Arrangements received

from clients since January 1, 1998, and any responses thereto.

14. All documents concerning any training of [name of broker] employees related to Compensation Arrangements.

15. A list of [name of broker] employees primarily responsible for the negotiation, analysis and management of Compensation Arrangements since January 1, 1998.

16. Documents created during the last 10 years concerning the analysis, tracking and recordkeeping of Compensation Arrangements, compensation to [name of broker] thereto and/or any benchmarks, quotas or cutoffs included in the Compensation Arrangements.

17. All documents concerning any analysis of the impact of Compensation Arrangement revenue on [name of broker]'s business and profitability.

18. Documents sufficient to show any investment by [name of broker] since January 1, 1998, in insurers with which [name of broker] places coverage on behalf of its clients.

19. All documents concerning any means by which [name of broker] received payments, either directly or indirectly, from insurers including, but not limited to, payments from joint ventures or partnerships with insurers or their affiliates, whether domestic, foreign or alien.

20. All documents concerning [name of broker]'s tying or conditioning the award of insurance business to an insurance company to the future employment of [name of broker].

21. All documents concerning loans to [name of broker] by an insurer.

22. All documents concerning [name of broker]'s receiving of stock or the option to purchase stock from an insurer.

23. All documents concerning any delay in [name of broker]'s forwarding of insurance premiums after [name of broker] has received payment for the premium from the insured or [name of broker]'s delay in forwarding payments from an insurer to its insured.

24. All documents concerning the preferential treatment of insurers who have entered into Compensation Arrangements with [name of broker] over other insurers.

25. Provide copies of all marketing materials disseminated to Washington risks since January 1, 1998.